DOW THEORY LETTERS INC.

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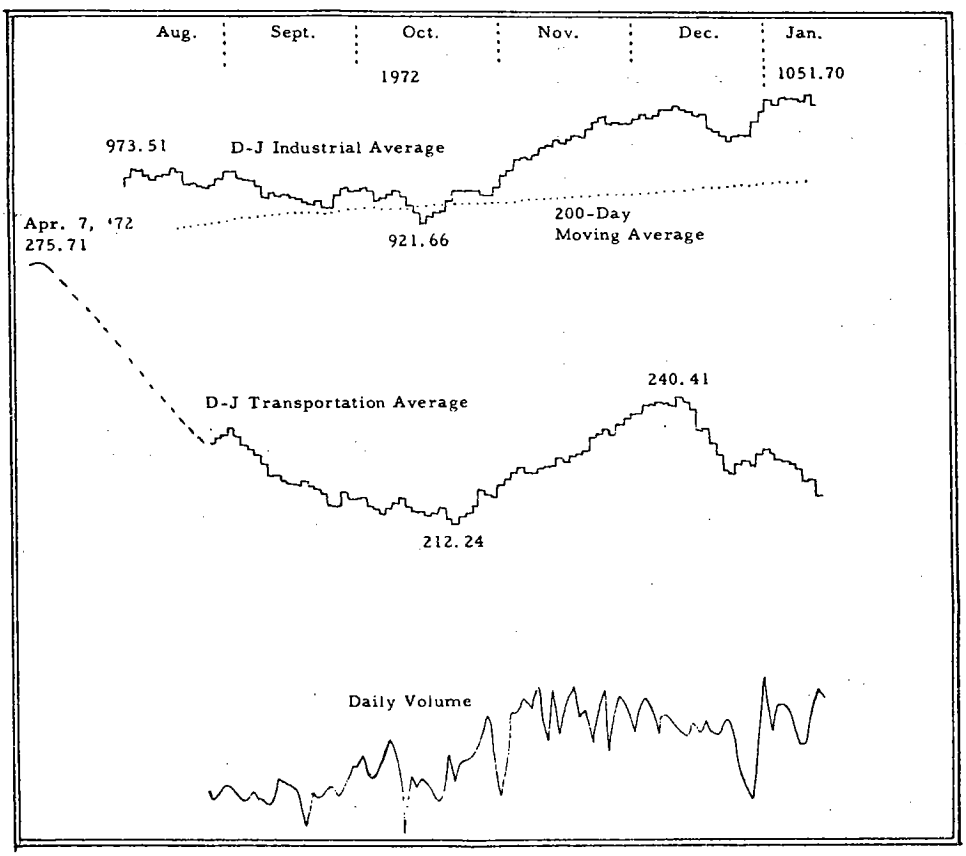
Jan. 5, Dow 1047.49, PTI 1036, A-D ratio -1.65
Jan. 12, Dow 1039.36, PTI 1030, A-D ratio -2.23

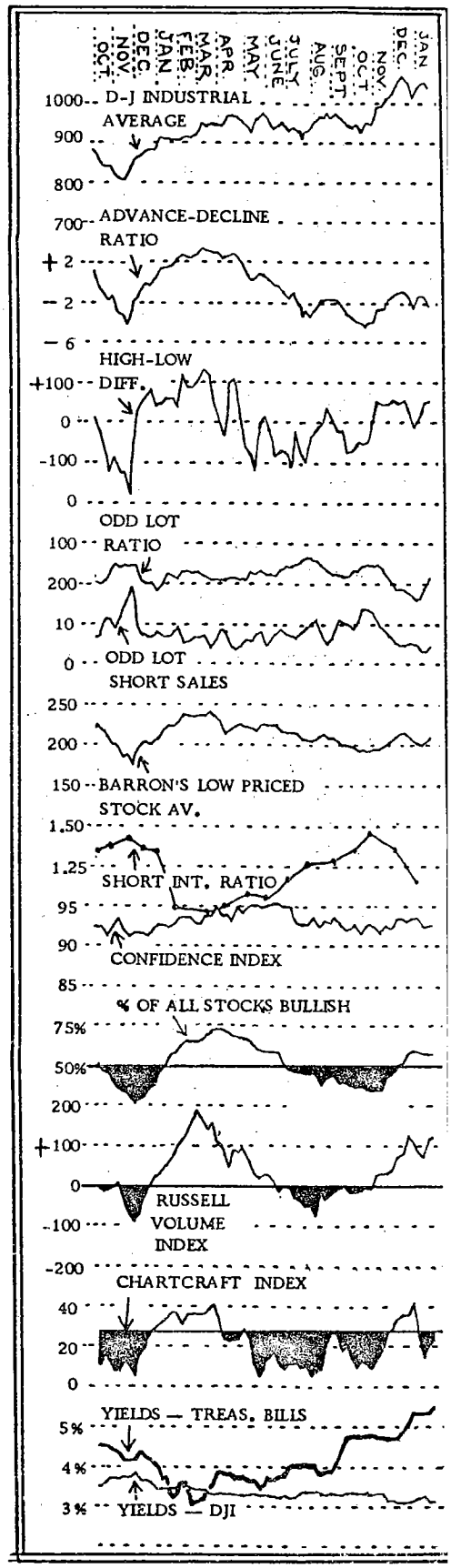
THE MARKET: "Whom the Gods would destroy, they first make mad." Does this explain the Administration's "thinking" behind Phase 3, or does the new "non-action" represent the culmination of secret commitments to business and labor? One thing appears certain to me, nothing "out in the open" or visible explains the latest Nixon action.

In view of the latest developments, I have taken a large amount of space in this report to review the gold situation. The gold picture represents what I view as an integral part of the "gathering storm." With the world's debt structure growing ever more top-heavy, with the money supply of nations across the Free World running rampant, with US inflation literally "decontrolled" and out of control, we can expect intelligent men to think increasingly in terms of protection and safety, rather than profits.

Unbridled inflation has toppled many a government. The question which then always arises is, what happens "after the fall?" One common result of an inflationary collapse is dictatorship. When governments turn to dictatorship, they take three things away from the people almost immediately. They take away the free press, so that the people do not have access to the truth. They take away all weapons, so that citizens cannot fight the forces of tyranny. They take away the right to own gold, so that the people can neither protect their life savings nor escape to another country (for gold is the "international currency," acceptable everywhere in any shape or form — with no questions asked).

Gun ownership rights are already under attack (it usually starts with pistols, then extends to all guns), and the free press is now under more persistent pressure than at any time in recent memory. Ironically and paradoxically, the Republican campaign platform





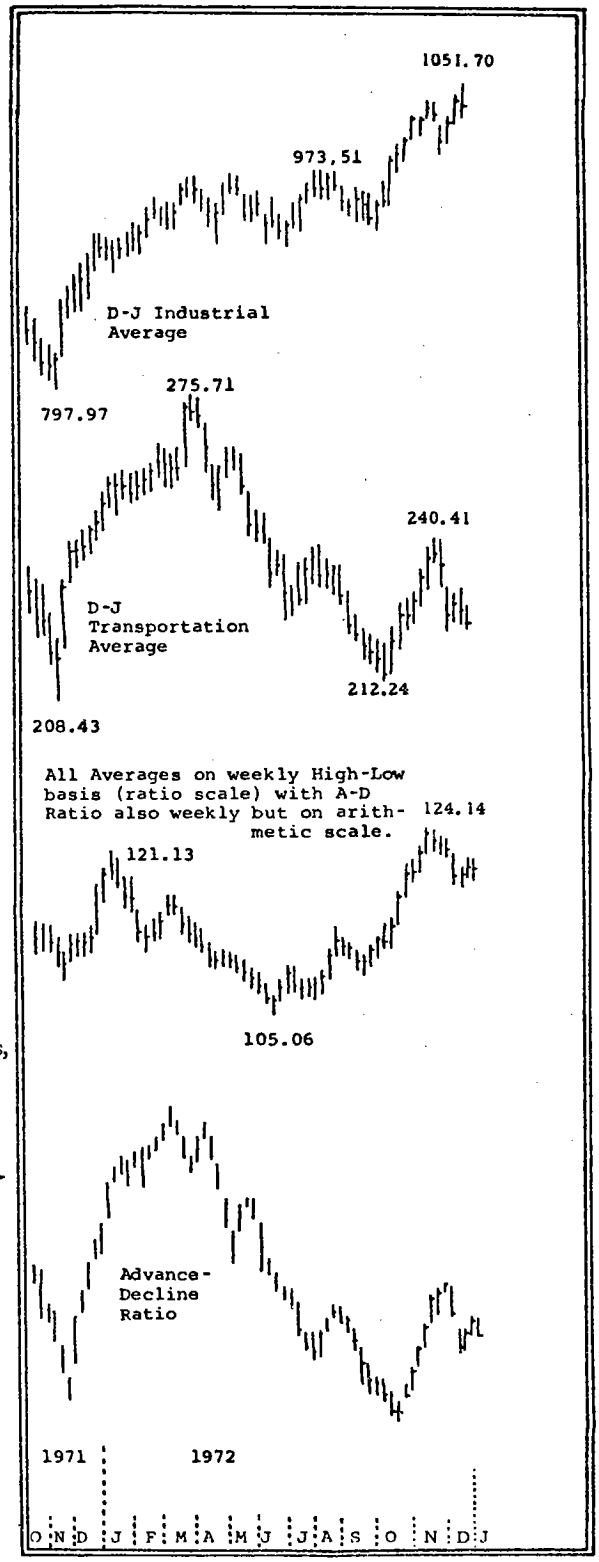
advocated that Americans regain their right to own gold – this at a time when the US Government has repeatedly expressed its wish to do away with gold altogether. Yet, gold has never been more with us. And the fact is that despite anti-gold propaganda in leading publications month after month, despite continual official denounciations, the gold bullion price is now less than $5 from its all-time high, gold stocks are strong, and no central bank that I know anything about is willing to sell its gold in order to settle international claims, not at any gold bullion price being quoted today.

Why am I writing all this? Because 1973 is shaping up as a fateful year. There are no monetary agreements near. Europe is becoming wary of SDR's. The US and Europe aren't even talking the same language regarding gold and dollar convertibility. The US is not correcting either its budget or its balance-of-payments deficits. The world monetary situation is getting worse, not better. The US is doing nothing and justifying its nothingness with the pathetic and widely broadcast thesis that since Europe is now inflating at a greater rate than the US, the US is in good shape. To which I say, "dream on..."

A second massive problem (which I have been writing about) is money rates, and on the page 1 composite chart (at bottom) we see that the spread between the Dow Industrial yield and 91-day Treasury bill yields is the widest (2.20 in favor of bills) in years. Aside from the yield spread, it is significant that from the yield standpoint alone, 91-day Treasury bills have only poked above the 5% yield level on five different occasions during this century, 1920-21, 1929, 1966, 1968-70 and in mid-1971 (dates courtesy of Holt Investment Advisory). An investigation of those dates (all except 1971) would indicate that they were associated with trouble in the stock market.

The problem of inflation is one that no President has seriously grappled with. Although Mr. Nixon ran on an anti-inflation ticket in both elections, he has literally "thrown in the sponge." I am convinced that he will live to regret his decision bitterly. The D-J spot commodity index has risen 28% over the last year, and this will be reflected in the cost of everything shortly. In my opinion, the lid is about to blow off prices in this country — and the result is going to be shock, consternation and fear. Then, when the real anti-inflation medicine arrives, as it ultimately must, it is going to be anything but painless.

All of these problems (plus the now you see it - now you don't — cease fire in Vietnam) the market is puzzling over, and all of them the market is attempting to discount. And just as the "bullishness" of the market is serving to hide trouble among a great mass of issues, so the bullishness of the economic soothsayers is serving to hide dozens of major, unsolved problems, problems in the political, social and financial fabric of the nation.



I am including my weekly chart of four major indicators which we follow and with which we gauge the market, the three D-J Averages and the advance-decline ratio. This chart last appeared in the mailing of December 22 (Letter 550), and the picture remains much the same now as then. The Industrial Average has rallied to new all-time highs in the 1050 area, but according to Dow's Theory the significance of this solo performance is highly questionable.

And the reason it is questionable is that the D-J Transportation Average has (1) failed to confirm the new Industrial highs. A confirmation would entail Transports bettering their own all-time high of 279.88 (recorded in 1969). Aside from failing to better the 279.88 high, Transports have not bettered their 1972 high of 275.71. Even worse, the Transports on the recent rally failed even to regain half of the losses suffered during 1972 (during the decline from 275.71 to 212.24). A recoup of just half of those losses would have meant an advance to 243.97, but as seen on the chart, the Transports rallied to 241.41, then turned down. This totally unsatisfactory and divergent performance on the part of Transports can be studied in greater detail on the page 1 chart.

From the standpoint of Dow Theory, a movement of one Average unconfirmed by the other is meaningless and more often than not deceptive. Therefore, it follows that the new highs on Industrials are to be viewed with great caution, and a continuation of the dismal Transportation performance will lead (as it almost always has) to trouble ahead.

Turning to the Utility Average, this indicator is still in a seven-year downtrend, one which began in late-1965 at 163.32. The 124.14 high of 1972 is below the 128.39 peak of 1971, and the 1971 peak is in turn below peaks recorded in 1969, 1968, 1967 and 1966. Until proved otherwise, the Utility high of 1972 must be accepted as just another of the good rallies which have punctuated the long-term decline since 1966.

Finally, the A-D ratio, following its October-December rally, is again weakening. This would indicate that the great body of stocks are unable, even on a short-term basis, to keep up with the bounce in the Dow. Perhaps the total picture has been put in best perspective by the widely-read Alan Abelson of Barron's (Jan. 8), "By any measure, we've had the skinniest bull market on record; a bunch of big name growth stocks going from merely overpriced to absolutely out of sight, while the rest of the list gives the best imitation of playing dead since Sarah Bernhardt left the boards..." Strong words in a national publication, but fortunately Abelson has always "played it as it lays."

In Letter 549 and again in 551 I included the chart of the four monetary indicators. I drew particular attention to the Aaa bond/Bill yield ratio, indicating that when the ratio dropped below 1.40 (as it had) monetary pressure would begin and a first sell signal would be registered. Since then stock margins have been boosted, bonds have been weak, 91-day Treasury bills have jumped above 5.20 in yield and the discount rate has been raised. This is just the beginning of the monetary pressure. Last week the Aaa/Bill yield ratio dropped to 1.33, not far from the critical 1.20 level (below 1.20 is the ratio's strongest sell signal).

A second indicator which deserves comment here is the most-active stock index, which measures the pluralities of the 15 most-active stocks (daily). This index dropped below zero on December 14 and stayed in minus territory during the whole December-January rally. That implied that the volume activity was on the downside, despite the new all-time high on the Dow, hardly a bullish background for the market.

For the period ahead, I feel that the Transportation Average may well provide the hints as to whether serious trouble is developing for the market at this time. I would say that a continued refusal by Transports to "move in gear" on the upside during market rallies will undermine the technical structure of the market to a point where broad weakness will take over from today's spotty strength.

GOLD'S HOUR DRAWS NEARER: There seem to be only a scattered few individuals in the nation who understand gold, and, in fact, very few who even understand what they read about gold. Two gentlemen who do understand the gold picture are New Englander Alden Wells and Texan Douglas Johnston. In his December 11, 1972, Monetary Report (Box 401, Exeter NH 03833) Wells reproduced word for word a report on an EEC Nations agreement regarding a new currency support system. The agreement appeared on the D-J News Service tape at 9:11, November 17. Wells explained the significance of the report in detail.

Then in the January, 1973, edition of the Alden R. Wells Quarterly, Douglas Johnston also examined the significance of the remarkable EEC agreement. I have taken the liberty of reproducing a section of Mr. Johnston's article. The first three paragraphs outline the actual terms of the EEC report:

In view of what Mr. Johnston writes, I want to go into the bullion picture again. In Letter 550 I included a daily chart of the London Gold Bullion price (based on the second daily fixing). I showed that following a doubling of the Free Market price of gold, from $35 to

If anyone still thinks there is not a master plan for gold, let him read an item carried by the Dow Jones News Service at 9:11 on November 17, 1972. This article was innocently worded, but closer reading revealed it to be a monetary bombshell. It was ignored by our press. It was an announcement, out of Luxembourg, on how the Common Market nations have agreed to operate their currency support system after January 1, 1973. In brief it declares that:

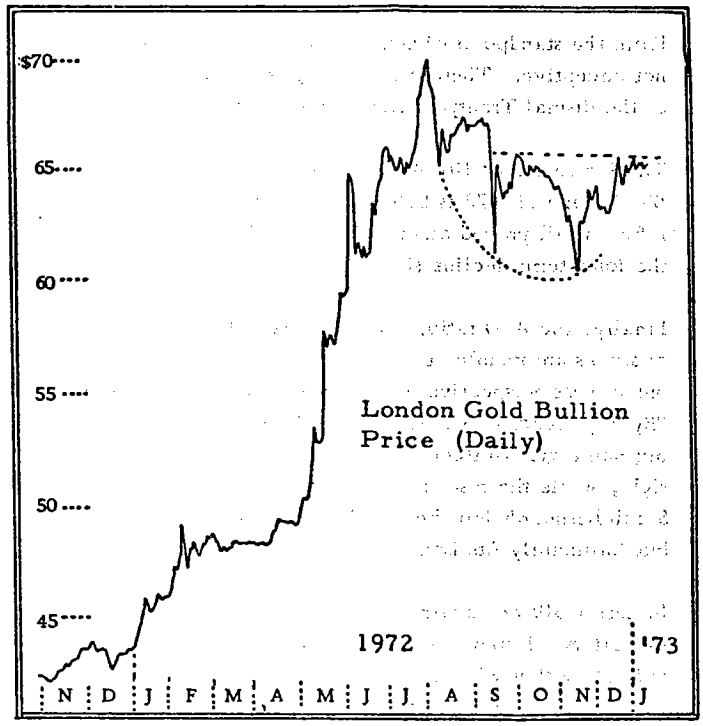
1) Gold will be used to settle debts between member nations.
2) Any member nation can defer paying the gold part of its debts until after an official price is set as part of a future general monetary settlement.
3) Here we quote exactly — "However, if a creditor nation nevertheless wishes repayment of the gold debt, the creditor can receive the equivalent *in dollars* calculated at the official gold dollar parity price of $38.00 an ounce."

COMMENT — #1 above is a flat assertion that gold is the monetary base. #2 is the greatest imaginable incentive for each Central Bank to get out and buy all the gold it can before a general settlement determines the new official price.

#3 really states that only stupid nations will take any more dollars in their reserves. Dollars are only good for settling gold debts *in paper* at $38.00, when gold is already above $60.00 in paper. There may be some stupid Central Bankers around, but none so simple that they would accept non-gold at a non-price. This provision alone is a clearcut notice to President Nixon that if he wants dollars accepted from now on, he is going to have to back them with gold at a realistic price.

Finally, it is probably no coincidence that this historic statement by the Common Market nations came on the exact day that gold hit its recent low at $60.10. The Central Banks were in agreement — they had a support level — they acted on it. And gold is once again moving higher.

$70, a correction took gold back to a November, 1972, low price of just over $60. From there, it became apparent that a "rounding bottom" was forming in the gold price; it also seemed most probable that the November price of $60 represented the low for the move. I wrote that if a common stock had advanced from 35 to 70, then corrected to only 60, the action would be considered sensational. I can only consider the price action of gold since 1970 sensational too.



The accompanying chart up-dated the daily gold price picture. Note that the rounding bottom previously referred to has now become a "head-and-shoulders" bottom formation. This structure seems powerful indeed. The upside breakout comes at $66. A bettering of the $66 level should put gold in line for an attack on the Free Market high of $70. Bettering $70 would mean a new ball game for gold in the eyes of the "public." The professionals already know that the ultimate price for gold is to be far above the current level. But the public, bombarded week after week by anti-gold propaganda, will only believe in gold after it has made the headlines again and again — via record high prices.

Meanwhile, the investment fraternity seems strangely unaware of what has been happening in the gold share picture, particularly the South African gold segment (S. African mines 78% of all the Free World's gold). I always find that comparisons are the most meaningful, and consequently I have included a section of my chart which compares the price of the Dow and the S. African Gold Index. The chart is drawn to ratio scale, which means that all movements show as percentages. Thus a rise from 50 to 100 on the Gold Index takes up exactly the same distance as an equal percentage rise of say 500 to 1000 or 450 to 900 on the Dow.

With this in mind, note that since the 1970 lows, the Gold Index has fared much better than the Dow Industrial Average. If the action is measured since the 1971 lows, the Gold Index has produced an even more remarkable performance. Now admittedly, all this is history and the subscriber (particularly the new subscribers) will want to know, "What's ahead?"

In my opinion, the first "gold objective" will be a move by London Bullion above the historic $70 peak. Then, I would expect the public (and Wall Street) to show increasing interest in the gold shares, and it would not surprise me to see another rise in the Gold Index fully as great (in percentages) as the 1971-72 rise, as seen on the chart. This move should be accompanied by more interest in gold shares than anything seen in this generation.

Gold Napoleons in France Climb to a Record Price

Special to The New York Times

PARIS, Dec. 15 — "It is the traditional refuge for the little guy when he is scared," the trader said as the feverish demand for Napoleons, the dime-sized gold coins resting under so many mattresses in France, lifted the price to a new high again today.

Napoleons are worth no more than $6.24 if valued on the basis of a gold centent of 5.826 grams. But they were worth $16 when the trading stopped today in the gold room of the stock exchange.

That means the price crossed 80 francs. Two months ago it was 73 francs. A week ago it was 75 francs. Ten years ago it was 40 francs.

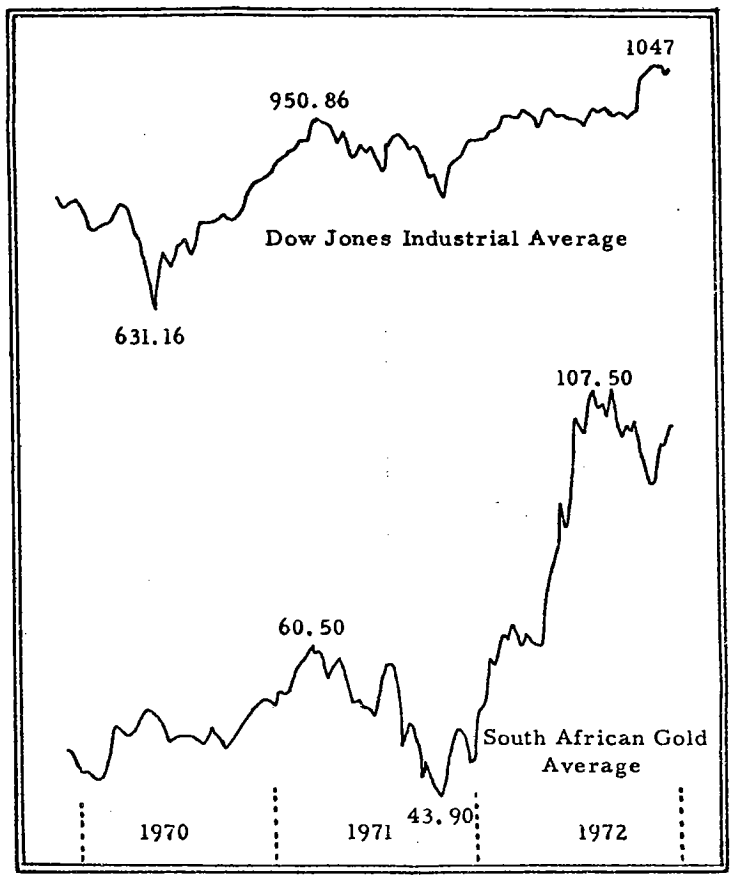
The Napoleon is the French Dow Jones. Both are confidence

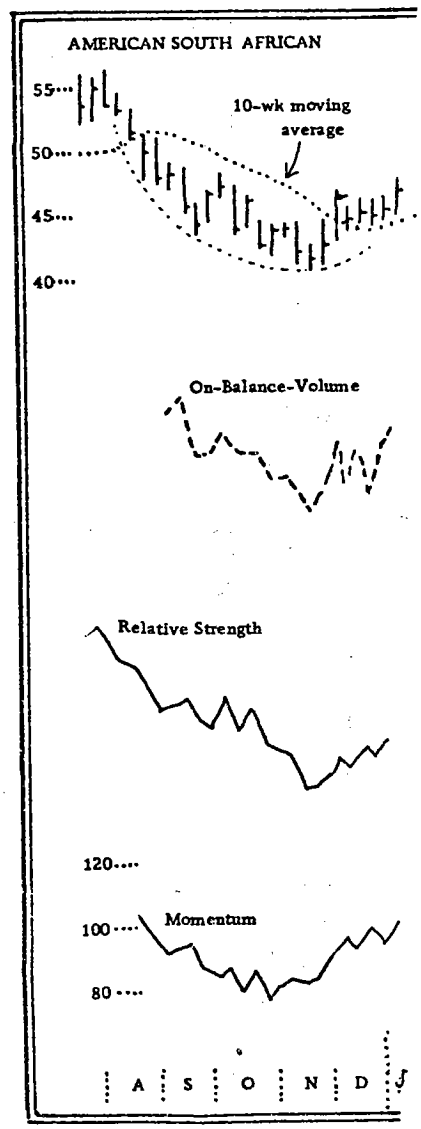
French Napoleon gold coin. It's the French Dow-Jones.

nomic and monetary statistics still look pretty good. She is running a comfortable trade surplus, her output is the high

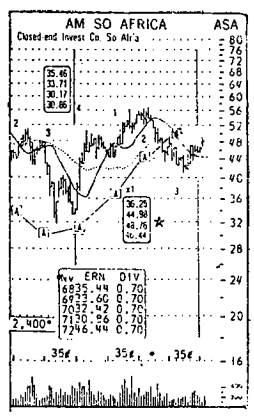
Here are a few statistics which I include through courtesy of Green's Commodity Market Comments, Box 174, Princeton, NJ 08540 (thank you Mr. Stahl). Both silver and gold increased about 48% in price during 1972. US consumption of gold hit an all-time high of 7.5 million ounces in 1972. This compares with 6.9 million ounces in 1971, 5.9 million in 1970. Can you imagine what will happen if the public obtains the legal right to own gold!

There is little question but that the current worldwide inflation will fan the flames of interest in gold. The Republican platform last year included a motion for the legalization of gold. Gold futures are now traded in Canada. This article about Gold Napoleons appeared in the New York Times a few weeks ago. Last week a new gold mutual (Au/Ag) was formed. I believe the ground is being prepared for the gold frenzy. Actually, the real groundwork was laid when the politicians of the world opted for inflation. Before it's all over, I'm sure they'll wish they never heard of inflation. But that's another story.





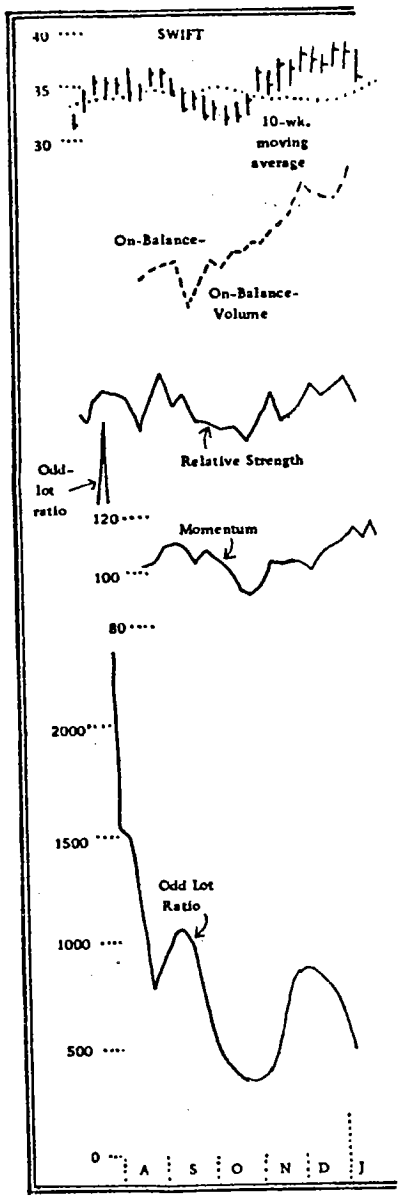
In closing this section, I want to up-date my own technical chart of American-South African Investment Co. Ltd. (ASA). This stock is the bellwether and the showpiece of the gold situation. The stock holds a majority of its funds in S. African mining shares, the only such issue listed on the NYSE. It has been around for years and is therefore a familiar issue to most investors. It has a reputation for being able to move rapidly, and it is a well-managed and highly respected company. ASA has, in the past, sold both above or below its net asset value. At present, NAV for ASA is probably above $49, and historically ASA has always been a good "buy" when it's sold below asset value. (The small weekly chart shows NAV of ASA in the line connecting the squares which enclose the letter "A". Chart courtesy of Quote Digest, Box 213, Wichita, Kansas 67201).

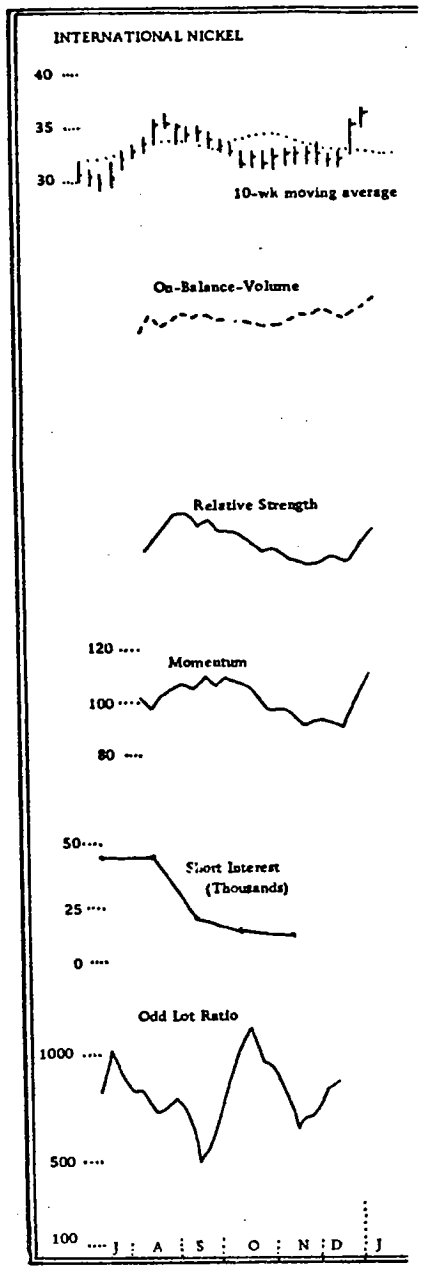


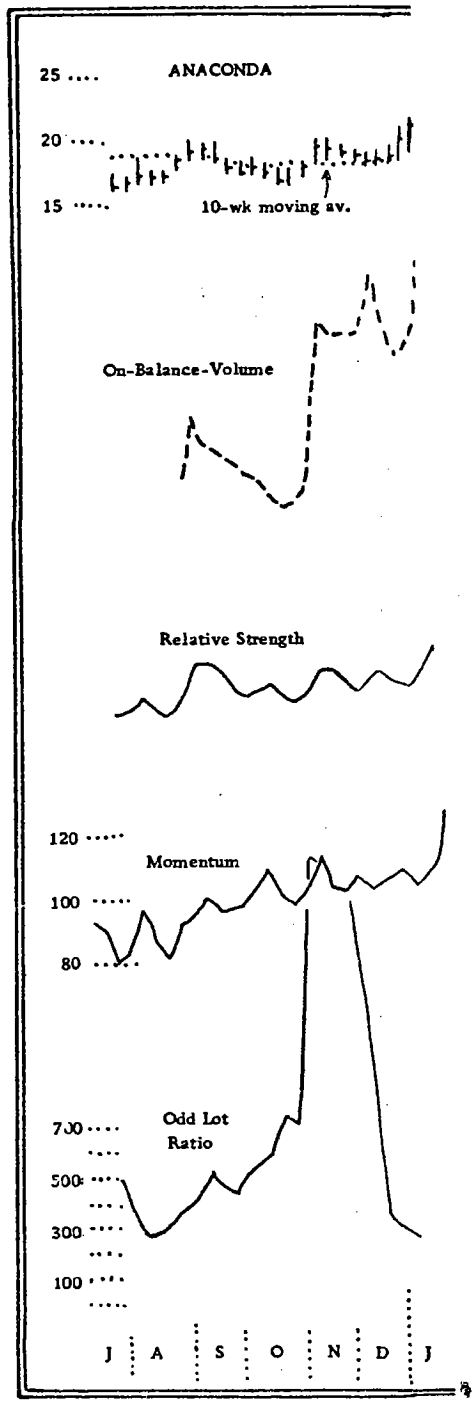
Blushingly I must state that my own weekly chart of ASA provides more critical technical information than any other chart available. Here we see ASA completing a "rounding bottom" formation, a formation characteristic of areas of quiet but persistent accumulation (the best kind). The stock has held above its 10-week moving average for six consecutive weeks, and the moving average is now rising, a bullish indication. On-balance-volume on ASA has been building up, and on January 15 upside volume jumped above the 10,000 mark, the heaviest daily volume for ASA in months. This OBV action confirmed the excellent recent price movement as the stock hurdles the 45-47 consolidation area.

In my opinion, ASA is gathering technical strength for an assault on the 1972 high of 56 7/8. Both relative strength and momentum are in uptrends, and this means that on a trend basis ASA is outperforming itself (or its price of 13 weeks ago) and is also outperforming the general market. In its present price range, I still consider ASA to be a good vehicle for participation in any gold move from here and an excellent hedge against further deterioration in paper money.

STOCKS: As the data builds up and as the new technical chart of the Dow stocks grow longer, certain fascinating observations present themselves. For instance, I note that over the past half year four Dow Industrials produced what I have termed "odd lot bulge." This is a sudden rise in the odd lot ratio to over 1000 (i.e., 1000 odd lot shares sold for every 100 bought). The bulge







occurred in Alcoa, Anaconda, Int. Nickel and Swift. In each case, if the stock had been purchased on the sell-off following the bulge, trading profits would have resulted.

To illustrate, I have included up-dated charts of Anaconda, Int. Nickel and Swift. I had recommended Swift and Anaconda in previous Letters as good trading vehicles, Swift in the 32-33 area and Anaconda in the 19 area. Both are up approximately 20% and both still appear as strong stocks in the Dow.

Note the upside odd-lot ratio bulge in Anaconda (A), which at its peak showed an odd-lot ratio of 1900. Following this, the stock dropped to a low of 18 7/8, then pushed out to 23. Int. Nickel (N) showed an odd-lot surge to 1200 in the ratio during October. The stock then settled back to 32, but more recently pushed up to above 36. Finally, Swift (SWX) produced a tremendous spate of odd-lot selling, bringing the ratio up to a staggering 3400. SWX then declined to below 32 before running up to 40.

I will provide charts of all Dow stocks with odd-lot ratios above 1000, and we will watch them to see if they perform in the future the way the "over 1000-ratio" stocks have performed up to now.

I might also add that a second good signal has been provided by trendline reversals in both relative strength and momentum, and I will write more of this in forthcoming Letters.